

# Interest Cost Risks to Government Budgets

by Jason Clemens, Milagros Palacios, and Jake Fuss



## SUMMARY

- This essay calculates the change in government interest costs and budget balances if interest costs return to their 2019-20 levels.
- Estimates are calculated for 2021-22 gross debt levels for each of the provinces and the federal government. Interest costs as a share of gross debt from 2019-20 are then applied to the estimated gross debt levels for 2021-22.
- The federal and nine provincial governments (except New Brunswick) all experience an increase in their interest costs. The largest dollar value and percentage increase is recorded by the federal government; interest costs rise from a budgeted \$22.1 billion in 2021-22 to \$35.2 billion, an increase of 59.4 percent. The smallest percentage increase is recorded by Quebec whose costs increase by 3.4 percent.
- Cumulatively, interest costs and deficits would increase by a total of \$17.0 billion in 2021-22 should interest costs return to their 2019-20 levels.
- The forecasted increase in federal interest costs for 2021-22 (\$13.1 billion) assuming interest costs return to their 2019-20 level represents 77.4 percent of the total increase in interest costs for the federal and provincial governments.
- Based on the risks assessed in this essay, governments across the country should employ much more caution regarding spending and borrowing, particularly in Ottawa.

# Interest Cost Risks to Government Budgets

## Introduction

A number of thought-leaders have raised concerns about the risks of higher interest rates and thus higher interest costs to not only Canadians generally but government finances more specifically.<sup>1</sup> This short essay answers a simple question: what would happen to government interest costs and budget balances if interest costs returned to their 2019-20 levels, which were already near historic lows.

This essay is not meant to infer or be interpreted as a prediction of interest rates. Rather, it simply assesses what would happen to government finances if interest costs, that is, the total amount of interest paid relative to the amount of gross debt outstanding, returned to their 2019-20 level. Contrary to the rhetoric employed by many governments across the coun-

try concerning low interest rates, a return to 2019-20 levels would further imperil many governments' finances.<sup>2</sup> Thus, governments across the country should employ much more caution in the levels of borrowing they are undertaking and planning for over the next number of years.

## 2019-20 debt statistics and interest costs

Table 1 summarizes debt and interest costs for the federal and provincial governments for 2019-20. Two statistics are particularly important. First, table 1 includes the ratio of gross debt to net debt. Gross debt refers to the total stock of debt for a specific government while net debt is calculated by deducting financial assets from gross debt. This is important for the calculations contained in table 2.

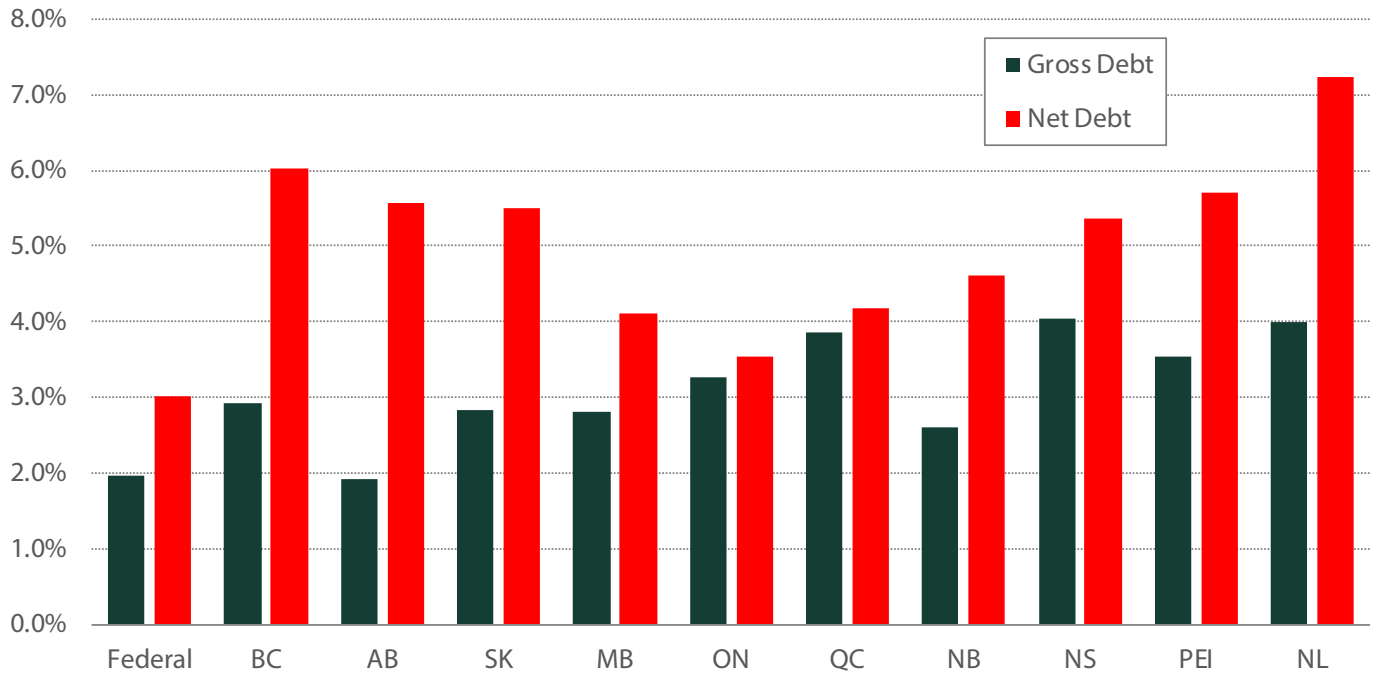
**Table 1: Debt Statistics and Interest Costs, 2019-20 (in millions where applicable)**

	Federal	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL
Interest Costs	24,447	2,727	2,235	675	1,037	12,495	7,676	643	818	126	1,043
Gross Debt	1,248,609	93,589	116,525	23,776	36,768	382,728	198,792	24,693	20,275	3,570	26,113
Net Debt	812,891	45,351	40,144	12,289	25,220	353,332	183,726	13,922	15,242	2,205	14,435
Ratio of Gross Debt to Net Debt	1.5	2.1	2.9	1.9	1.5	1.1	1.1	1.8	1.3	1.6	1.8
Effective Interest Costs - Gross Debt	2.0%	2.9%	1.9%	2.8%	2.8%	3.3%	3.9%	2.6%	4.0%	3.5%	4.0%

Sources: Canada, Department of Finance, *Fiscal Reference Tables* (November 2020). <<https://www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables/2020.html>>; Alberta, *Budget 2021*. <<https://www.alberta.ca/budget.aspx>>; British Columbia, *Budget 2021*. <<https://www.bcbudget.gov.bc.ca/2021/default.htm>>; Manitoba, *Public Accounts 2019-20*. <<https://www.gov.mb.ca/government/finances/annualreports-publicaccounts.html>>; New Brunswick, *Public Accounts 2019-20*, Vol. 1, Consolidated Financial Statements for the Fiscal Year ended 31 March 2020. <<https://www2.gnb.ca/content/dam/gnb/Departments/tb-ct/pdf/OC/PA2020v1.pdf>>; Newfoundland & Labrador, *Public Accounts Consolidated Summary Financial Statements 2019-20*. <<https://www.gov.nl.ca/exec/tbs/files/Public-Accounts-2019-20.pdf>>; Nova Scotia, *Public Accounts 2019-20*. <<https://notices.novascotia.ca/files/public-accounts/2020/2020public-accounts-volume-1.pdf>>; Ontario, *Budget 2021*. <<https://budget.ontario.ca/2021/index.html>>; Prince Edward Island, *Public Accounts 2019-20*, Vol. 1. <<https://www.princeedwardisland.ca/en/information/finance/public-accounts>>; Quebec, *Budget 2021*. <[http://www.budget.finances.gouv.qc.ca/budget/2021-2022/index\\_en.asp](http://www.budget.finances.gouv.qc.ca/budget/2021-2022/index_en.asp)>; Saskatchewan, *Public Accounts 2019-20*. <<https://publications.saskatchewan.ca/#/categories/4518>>; calculations by authors.

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Figure 1: Effective Interest Costs, Gross Debt vs. Net Debt, 2019-20



Source: See Table 1.

Second, table 1 includes a calculation of interest costs as a share of gross debt. It's a way of assessing the interest costs relative to the level of debt.

## Estimating gross debt for 2021-22

One of the challenges in estimating interest costs for 2021-22 based on the costs experienced in 2019-20 is the lack of gross debt statistics. Specifically, five provinces did not report 2021-22 gross debt statistics: Manitoba and four Atlantic Canadian provinces. This is important because interest costs are a function of gross debt. And while net debt statistics for 2021-22 are available, they are not a sound substitute for gross debt. Indeed, as figure 1 illustrates, there's a distinctly different pattern

between the federal and the provincial governments on interest costs depending on whether gross debt or net debt statistics are used.

Table 2 contains debt statistics and interest costs for 2021-22, including the calculations used to estimate gross debt for 2021-22 for the five provinces for which data was not available. Specifically, the ratio of gross debt to net debt from 2019-20 is applied to the projected net debt statistics available for 2021-22 to estimate gross debt for 2021-22. The interest costs (as a percentage) based on gross debt from 2019-20 are then applied to the projected gross debt statistics for 2021-22 to calculate what would happen to interest costs for the federal and provincial governments if interest costs returned to their 2019-20 level.

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**Table 2: Debt Statistics and Interest Costs, 2021-22 (in millions where applicable)**

	Federal	BC	AB	SK	MB	ON	QC	NB	NS	PEI	NL
<b>2019-20:</b>											
Effective Interest Costs - Gross Debt	2.0%	2.9%	1.9%	2.8%	2.8%	3.3%	3.9%	2.6%	4.0%	3.5%	4.0%
Ratio of Gross Debt to Net Debt	1.5	2.1	2.9	1.9	1.5	1.1	1.1	1.8	1.3	1.6	1.8
<b>2021-22:</b>											
Net Debt	1,333,600	71,922	82,161	17,585	29,998	439,844	213,020	14,132	17,976	2,634	17,218
Gross Debt (1)	1,799,700	126,938	153,329	30,213	43,734	450,559	230,314	25,066	23,911	4,265	31,147
Interest Costs	22,100	2,777	2,764	755	994	13,130	8,600	655	711	128	995
Adjusted Interest Costs (2)	35,237	3,699	2,941	858	1,233	14,709	8,893	652	965	151	1,244
Change from 2021-22 Budget	13,137	922	177	103	239	1,579	293	-3	254	23	249
Change in Interest Costs (%)	59.4%	33.2%	6.4%	13.6%	24.1%	12.0%	3.4%	-0.4%	35.7%	18.0%	25.0%
Expected Deficit	154,700	9,698	18,221	2,611	1,597	33,108	12,300	245	585	112	825
Revised Deficit	167,837	10,620	18,398	2,714	1,836	34,687	12,593	242	839	135	1,074
Change in Deficit (%)	8.5%	9.5%	1.0%	3.9%	15.0%	4.8%	2.4%	-1.1%	43.4%	20.5%	30.2%

## Notes:

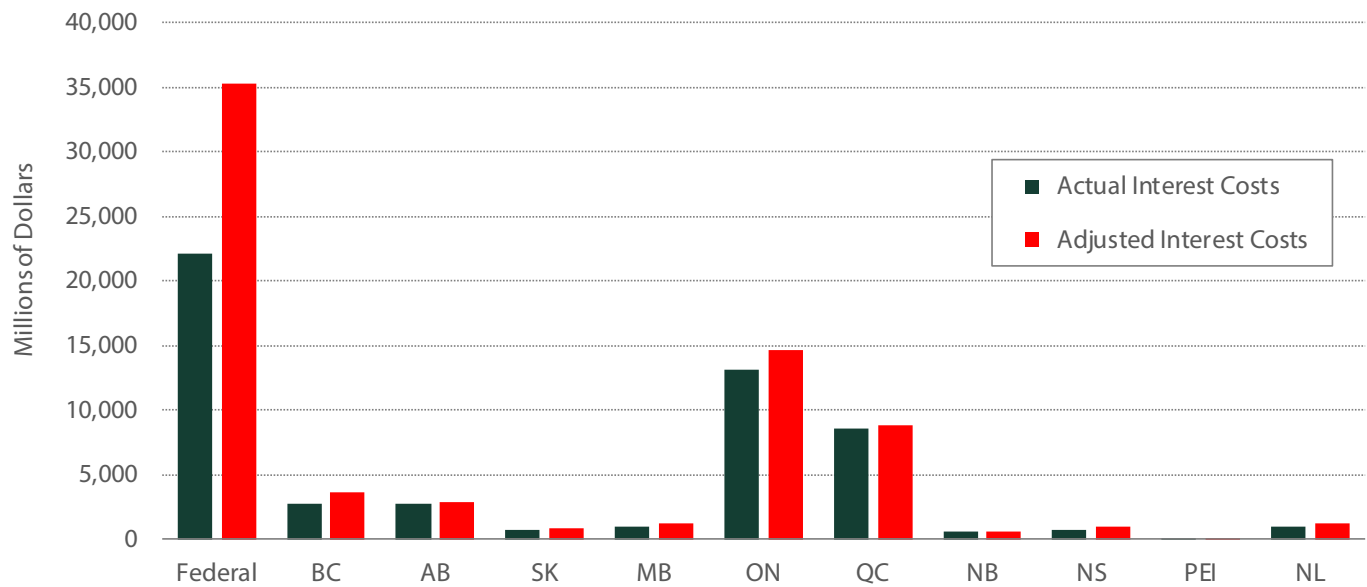
1 - Gross debt for 2021-22 for Manitoba, New Brunswick, Nova Scotia, PEI and Newfoundland and Labrador are based on estimates using net debt for 2021-22 and the ratio of gross debt to net debt from 2019-20.

2 - Interest costs are calculated by applying the effective interest cost from 2019-20 to the revised gross debt estimate for 2021-22.

Sources: Table 1; Canada, Department of Finance, *Budget 2021* <<https://www.budget.gc.ca/2021/home-accueil-en.html>>; Alberta, *Budget 2021* <<https://www.alberta.ca/budget.aspx>>; British Columbia, *Budget 2021* <<https://www.bcbudget.gov.bc.ca/2021/default.htm>>; Saskatchewan, *Budget 2021* <<https://www.saskatchewan.ca/government/budget-planning-and-reporting/budget-2021-22>>; Manitoba, *Budget 2021* <<https://www.gov.mb.ca/budget2021/index.html>>; Ontario, *Budget 2021* <<https://budget.ontario.ca/2021/index.html>>; Quebec, *Budget 2021* <[http://www.budget.finances.gouv.qc.ca/budget/2021-2022/index\\_en.asp](http://www.budget.finances.gouv.qc.ca/budget/2021-2022/index_en.asp)>; New Brunswick, *Budget 2021* <<https://www2.gnb.ca/content/gnb/en/departments/finance/budget/2021-2022/budget.html>>; Nova Scotia, *Budget 2021* <<https://beta.novascotia.ca/documents/budget-documents-2021-2022>>; Prince Edward Island, *Budget 2021* <<https://www.princeedwardisland.ca/en/information/finance/provincial-budget-operating-budget>>; Newfoundland & Labrador, *Budget 2021* <<https://www.gov.nl.ca/budget/2021/>>; calculations by authors.

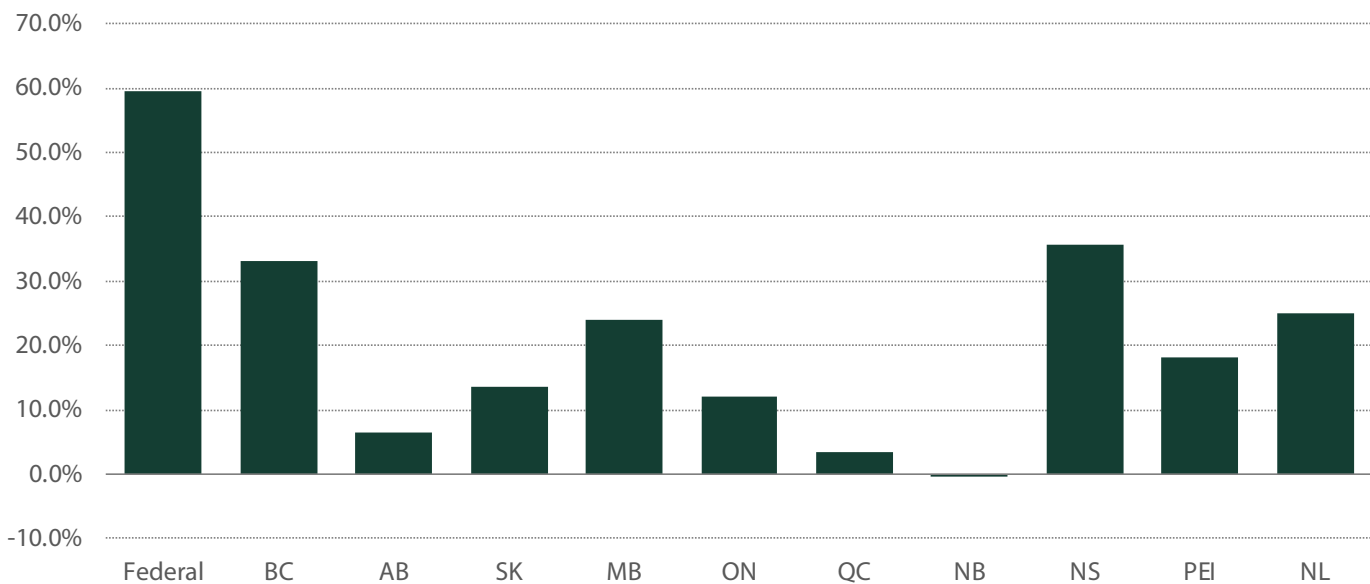
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**Figure 2: Actual Interest Costs vs. Adjusted Interest Costs, 2021-22**



Sources and Notes: See Table 2.

**Figure 3: Change in Interest Cost (%), 2021-22**



Sources and Notes: See Table 2.

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**Table 3: Analysis of Federal Interest Costs**

	2021-22	2022-23	2023-24	2024-25	2025-26
Gross Debt, in \$ billions	1,799.7	1,858.3	1,928.0	1,983.1	2,025.3
Interest Costs, in \$ billions	22.1	25.7	30.5	35.4	39.3
Interest Costs as a Share of Gross Debt	1.2%	1.4%	1.6%	1.8%	1.9%
Deficit, in \$ billions	154.7	59.7	51	35.8	30.7
Adjusted Interest Costs, in \$ billions	35.2	36.4	37.7	38.8	39.7
Difference, in \$ billions	13.1	10.7	7.2	3.4	0.4

Sources: Canada, Department of Finance (2021), *Federal Budget 2021* <<https://www.budget.gc.ca/2021/home-accueil-en.html>>; calculations by authors.

## Higher interest costs

Figure 2 illustrates the difference between the actual interest costs budgeted for by the various governments for 2021-22 and the revised estimate based on the calculation noted above and included in table 2. Figure 3 illustrates the percentage change in interest costs between the budgeted amount for 2021-22 and the revised estimate based on the calculations in table 2.

The federal and nine provincial governments (except New Brunswick) all see their interest costs increase. The federal government records the largest dollar value and percentage increase. Specifically, interest costs rise from a budgeted level of \$22.1 billion in 2021-22 to \$35.2 billion, an increase of 59.4 percent. Quebec, whose costs increase by 3.4 percent, records the smallest percentage increase.

New Brunswick actually experiences a small decrease in interest costs based on its comparatively conservative assumption of interest costs in its 2021-22 budget.

Cumulatively, interest costs and thus deficits would increase by a total of \$17.0 billion in

2021-22 should interest costs return to their 2019-20 levels.

The changes in interest costs, assuming no changes in revenues or other spending, results in worsening deficits for the federal government and nine of the provinces. Again, New Brunswick's conservative estimate of interest costs in its 2021-22 budget means that incorporating 2019-20 interest costs results in effectively no change in interest costs. As table 2 shows, the deficit of the federal government would increase from \$154.7 billion to \$167.8 billion. Cumulatively the deficits of the federal and provincial governments would increase from \$234.0 billion to \$251.0 billion.

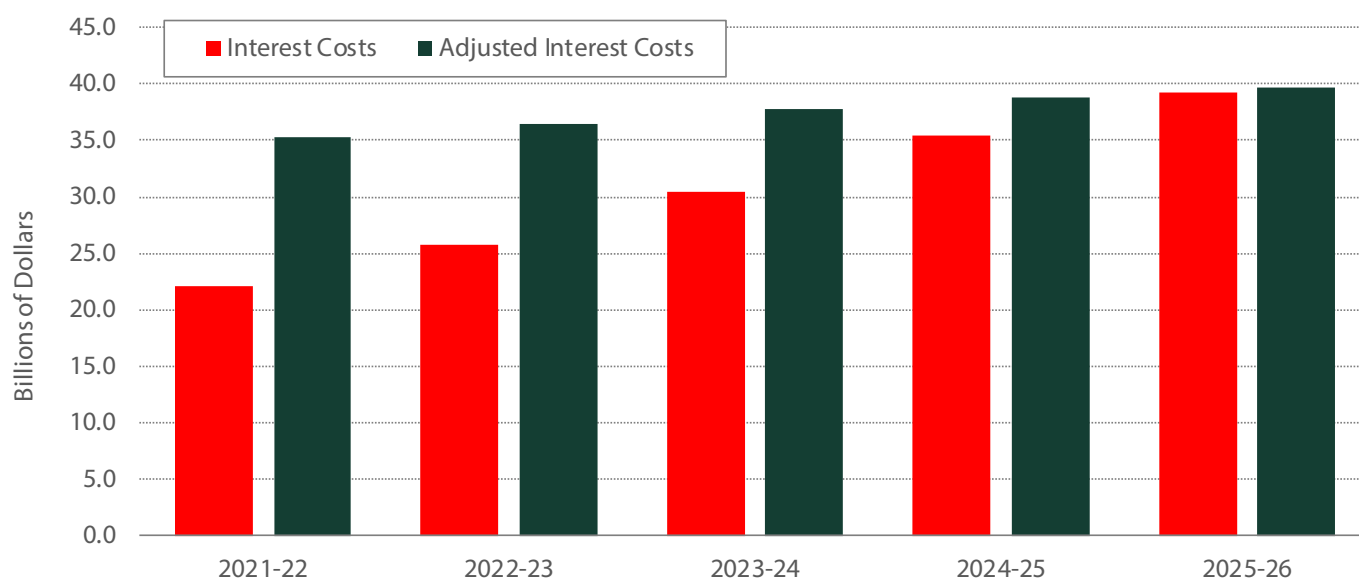
## Expanded federal analysis

The forecasted increase in federal interest costs for 2021-22 (\$13.1 billion) assuming interest costs return to their 2019-20 level represents 77.4 percent of the total increase in interest costs for the federal and provincial governments. Given the concentration of the interest cost risk with the federal government, it's worth looking at the longer-term data provided in the federal government's *Budget 2021*.



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Figure 4: Change in Federal Interest Costs, 2021-22 to 2025-26



Sources: Canada, Department of Finance (2021), *Federal Budget 2021* <<https://www.budget.gc.ca/2021/home-accueil-en.html>>; calculations by authors.

Table 3 contains debt and interest costs data from *Budget 2021* for the federal government for 2021-22 through to 2025-26, the five-year period covered by the budget. Using the same methodology, namely, applying the effective interest costs from 2019-20 (2.0 percent) to the gross debt projections provided in *Budget 2021* for the five-year period, the result is a rise in interest costs of \$34.9 billion. Figure 4 illustrates actual federal interest costs and adjusted federal interest costs and shows the majority of the higher costs occurring in 2021-22 through to 2023-24. The higher interest costs, again assuming no changes in revenues or spending, would result in higher deficits and higher debt accumulation, which could further increase interest costs beyond the estimates provided.

## Conclusion

It's clear that governments across the country, and in particular the federal government, risk higher interest costs and eroding public finances should interest costs return to their 2019-20 levels, which were already historically low. Governments, particularly the federal government, need to show greater caution and prudence with respect to continued debt-financed spending and the related debt accumulation.

## Endnotes

- <sup>1</sup> See, for instance, Andrew Coyne (2021, April 17), *Dealing with the Debt: If We're Not Prepared to Cut Spending, Then We Have to Get Serious about Growth*, *Globe and Mail* <<https://www.theglobeandmail.com/opinion/article-dealing-with-the-debt-if-were-not-prepared-to-cut-spending-then-we/>>, as of June 2, 2021; Jack M. Mintz (2021, April 29), *Let's Stress-Test Government*, *Financial*

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Post <<https://financialpost.com/opinion/jack-mintz-lets-stress-test-government>>, as of June 2, 2021; Martin Pelletier (2021, April 30), In an Era of Loose Fiscal and Monetary Policy Cutting your Canada Exposure May Be the Best Option. *Financial Post* <<https://financialpost.com/investing/in-an-era-of-loose-fiscal-and-monetary-policy-cutting-your-canada-exposure-may-be-the-best-option>>, as of June 2, 2021; and Benjamin Tal (2021, May 10), We've Never Been So Sensitive to the Risk of Higher Interest Rates, *Bloomberg Markets* <<https://www.bnnbloomberg.ca/economics/video/we-ve-never-been-so-sensitive-to-the-risk-of-higher-interest-rates-cibc-s-tal-2153428>>, as of June 2, 2021.

<sup>2</sup> See Aaron Wherry (2020, October 20), Keep Calm and Borrow On: Chrystia Freeland and the New Logic of Deficits in a Pandemic, *CBC News* <<https://www.cbc.ca/news/politics/freeland-deficit-pandemic-covid-otoole-poilievre-1.5780809>>, as of June 2, 2021.



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ISSN 2291-8620

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## Acknowledgments

The authors wish to thank the anonymous reviewers for their suggestions and feedback. Any remaining errors or oversights are the sole responsibility of the authors.

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